

D.T.E. 04-79

October 1, 2004

Investigation by the Department of Telecommunications and Energy on its own motion as to the propriety of the rates and charges by Blackstone Gas Company set forth in M.D.T.E. Nos. 80 through 85, filed with the Department on August 17, 2004, to become effective November 1, 2004.

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FOR: Blackstone Gas Company  
Petitioner

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Intervenor

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ORDER ON OFFER OF SETTLEMENT

I. INTRODUCTION

\_\_\_\_\_ On August 17, 2004, Blackstone Gas Company (“Blackstone” or “Company”) filed with the Department of Telecommunications and Energy (“Department”) a Settlement Agreement (“Settlement”) between the Company and the Attorney General (together, “Settling Parties”). The Settling Parties state that the Settlement resolves all issues related to a proposed base rate increase to become effective November 1, 2004 (Exh. Blackstone-1, at 1).<sup>1</sup> The Settlement provides for the adoption of a performance based rate plan (“PBR Plan”) (id.). The matter was docketed as D.T.E. 04-79.

Pursuant to notice duly issued, the Department conducted a public hearing in the Town of Blackstone on September 22, 2004. The Attorney General intervened pursuant to G.L. c. 12, § 11E. The evidentiary record consists of 26 exhibits.<sup>2</sup>

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<sup>1</sup> In Blackstone Gas Company, D.T.E. 01-50, at 23 (2001), the Department directed the Company to submit details on how it intended to contain future rate case expenses. The Department suggested that the Company engage in settlement negotiations as part of future rate requests because its future rate case expense in a litigated proceeding would be disproportionate to the total relief sought. Id. The Company states that it submits the Settlement in response to this concern of the Department (Exh. Blackstone-2, at 1.1).

<sup>2</sup> The Department hereby moves and admits into evidence the following: the Company’s filing (Exh. Blackstone-1); the Settlement including the attachments and schedules (Exh. Blackstone-2); and the responses to the Department’s 24 information requests (DTE 1-1 through DTE 1-24).

## II. DESCRIPTION OF PROPOSED SETTLEMENT

The Settlement includes a cost of service study (“COSS”) that uses as a test year the Company’s costs during calendar year 2002 with a pro-forma adjustment to include the reduced cost of long-term debt obtained by the Company and approved by the Department in Blackstone Gas Company, D.T.E. 03-65 (2003), and a pro-forma adjustment to include what the Settling Parties proposed as a known and measurable increase in liability insurance (Exh. Blackstone-2, at 1.2).<sup>3</sup> Also, the COSS normalizes for weather the billing determinants used to determine 2002 test year revenues (id.).

The Settling Parties have proposed to increase base rates to collect an additional \$40,000 in revenues over the normalized level in the 2002 test year (id. at 1.3).<sup>4</sup> The Settling Parties propose allocating the \$40,000 increase to the Company’s customers as follows: \$8,500 to the Rate S-1 (School) class; and the remaining \$31,500 to the other rate classes on an equal cents per cubic foot basis (id.; Exh. DTE 1-8, at Schedule 1). Of the \$31,500 increase, the Company’s Residential Heating class would be allocated \$20,330, the Residential Non-heating class would be allocated \$1,403, and the Commercial class (Rate G-1) would be allocated \$9,767 (Exh. DTE 1-8, at Schedule 1).

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<sup>3</sup> Blackstone states that, subject to approval of the Settlement, it will withdraw its request for an accounting deferral of certain legal and consulting expenses that was docketed by the Department as D.T.E. 04-59 (Exhs. Blackstone-1; Blackstone-2, at 4.1).

<sup>4</sup> The COSS determined a revenue deficiency of \$83,860 for the Company (Exh. Blackstone-2 at 1.3; Settlement Exhibit B; Exh. DTE 1-8, at Schedule 1).

The Settling Parties have also agreed on a PBR Plan with a five-year term, with the first adjustment effective on November 1, 2005, and the last adjustment effective on November 1, 2009 (Exh. Blackstone-2, at 1.4, 2.2). The Settlement proposes that the PBR Plan be implemented as follows: by June 1 of each year during the five-year term, the Company would submit a compliance filing to the Department and the Attorney General to adjust base rates based on a price-cap formula and an earnings sharing mechanism (id. at 2.3). According to the proposed PBR Plan, any changes to base rates would be recovered equally across all cubic feet of gas consumed by Blackstone's customers, unless the Parties agree that an alternative allocation is just and reasonable (id.). Further, according to the Settlement, the Company would comply with the Department's requirements regarding service quality for companies under PBR plans, and notwithstanding the base rate changes provided in the proposed agreement, rates would be adjusted for any service quality penalties that may result from the Department's requirements (id. at 2.4). Last, the Settlement states that any service quality penalties the Company incurs would be deducted from the Company's earnings before determining the rate of return on common equity for the earnings sharing mechanism (id. at 2.5).<sup>5</sup>

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<sup>5</sup> Currently, companies with PBR plans comply with the guidelines established in Service Quality Standards for Electric Distribution Companies and Local Gas Distribution Companies, 99-84 (2001). If these guidelines are revised in the future, Blackstone will be required to comply with the revised guidelines.

The primary component of the PBR Plan is a price-cap formula that would apply to the Company's distribution service rates (id. at 2.3). The proposed price-cap formula is defined as:

$$P_t = P_{(t-1)} * (1 + I_t - X \pm Z_t)$$

where  $P_t$  is the Company's weighted average price in year  $t$ ;  $P_{(t-1)}$  is the Company's weighted average price in year  $t-1$  (id.);  $I_t$ , the inflation index for the year  $t$ , is the chain-weighted gross domestic product index ("GDP-PI") measured as the percentage change between the average for the current year's and prior year's four quarterly measures of the GDP-PI (id.);  $X$  is the productivity factor that would be fixed at one-half of one percent for each year of the PBR Plan (id.);  $Z_t$  is the exogenous cost factor, that would represent the effect on base rates of certain exogenous changes that affect the Company's unit cost in year  $t$  but are not incorporated in the inflation or  $X$ -factors (id.).

The exogenous cost factor would allow the Company to adjust its distribution rates (upward or downward) for each exogenous change that increases or decreases the Company's revenue requirement by more than \$5,000 on an annual basis (id.). Exogenous change would be defined as positive or negative cost changes beyond the Company's control and not reflected in the GDP-PI, including, but not limited to, cost changes resulting from changes in tax laws that uniquely affect the local gas distribution industry; accounting changes unique to the local gas distribution industry; and regulatory, judicial, or legislative changes uniquely affecting the local gas distribution industry (id.).

The Settlement provides for an earnings sharing mechanism if the earned return on common equity of the Company is plus or minus 400 basis points from the current allowed rate of return on common equity of 10.5 percent (id. at 2.5). Thus, if the Company's annual rate of return on average common equity as reported in the Company's annual return to the Department for the previous year, unadjusted for weather is:

1. above 14.5 percent, the Company would reduce its base rates by a uniform per cubic foot credit in an amount equal to one-half of the difference between the Company's earned return and the return associated with the 14.5 percent, plus associated income taxes;
2. below 6.5 percent, the Company would increase its base rates by a uniform per cubic foot surcharge in an amount equal to one-half of the difference between the return associated with 6.5 percent and the Company's earned return, plus associated income taxes; or
3. between 6.5 and 14.5 percent, no further adjustments to the PBR Plan calculation shall be authorized or required (id.).

The proposed Settlement states that, for the purposes of the earned rate of return calculation, the total compensation, excluding health care benefit costs, of the current President of the Company, and any of his immediate family employed by the Company, shall not increase from their respective 2002 levels by more than the cumulative increase in the GDP-PI from December 2002 (id.). Any increases above the inflation factor shall be added to net income less applicable taxes before calculating the earnings sharing (id.).

The Settling Parties agree that the Company will depreciate plant in service at the same accrual rate for each plant account as the Department approved in D.T.E. 01-50 (id.). Rate adjustments authorized would become effective on November 1, 2005 at the same time as the first proposed PBR Plan increase (id.).

With regard to an appropriate rate of return on common equity, the Settling Parties state that, for the purposes of calculating (i) the allowance for funds used during construction, and (ii) the purchased gas working capital allowance and any other components of the Cost of Gas Adjustment Clause (“CGAC”) where a rate of return is required, a rate of 10.5 percent shall be used for common equity, and an effective rate of six percent shall be used for long-term debt (id. at 2.6).

### III. STANDARD OF REVIEW

In assessing the reasonableness of an offer of settlement, the Department must review all available information to ensure that the settlement is consistent with Department precedent and the public interest. Fall River Gas Company, D.P.U. 96-60 (1996); Essex County Gas Company, D.P.U. 96-70 (1996); Boston Edison Company, D.P.U. 92-130-D at 5 (1996); Bay State Gas Company, D.P.U. 95-104, at 14-15 (1995); Boston Edison Company, D.P.U. 88-28/88-48/89-100, at 9 (1989). A settlement among the parties does not relieve the Department of its statutory obligation to conclude its investigation with a finding that a just and reasonable outcome will result. Bay State Gas Company, D.P.U. 95-104, at 15 (1995); Boston Edison Company, D.P.U. 88-28/88-48/89-100, at 9 (1989).

It is well established that the Department’s goals for utility rate structure are efficiency, simplicity, continuity, fairness, and earnings stability. Bay State Gas Company, D.P.U. 95-104, at 15 (1995); Bay State Gas Company, D.P.U. 92-111, at 283 (1992). See also Massachusetts Electric Company, D.P.U. 95-40, at 144-145 (1995). The Department has previously accepted settlements which include cost allocation and/or rate design when such

settlements were consistent with the Department's goals. Fall River Gas Company, D.P.U. 96-60 (1996); Essex County Gas Company, D.P.U. 96-70 (1996); Bay State Gas Company, D.P.U. 95-104, at 15 (1995); Massachusetts Electric Company, D.P.U. 91-52 (1991).

#### IV. ANALYSIS AND FINDINGS

The Department has evaluated the provisions of the Settlement based on the information submitted by the Settlement Parties in attachments, schedules and responses to information requests by the Department. Based upon this review, in particular the COSS and bill impact analyses, the Department finds that the Settlement balances the competing goals of allocating costs while maintaining rate structure principles of efficiency, simplicity, continuity, fairness, and earnings stability. The Department further finds that the resulting allocation of costs and rates is just and reasonable.

Based on a review of the provisions included in the proposed PBR Plan, the Department finds that the PBR Plan is reasonably consistent with past Department approved PBR Plans. Further, we find that the PBR Plan offers the benefit of reduced costs to the Company and its ratepayers. In conclusion, the Settlement, taken as a whole, produces a fair result and provides a level of additional revenues for the Company that are reasonably consistent with the rate levels that would have been approved by the Department in the absence of a settlement.

Therefore, the Department finds the Settlement to be in the public interest and approves the Settlement. The Department's approval of the Settlement does not constitute a



determination as to the merits of any allegations, contentions, or arguments made in this proceeding. In addition, the Department's approval does not establish a precedent for future filings, whether ultimately settled or adjudicated.

V. ORDER

Accordingly, after due notice, hearing and consideration, it is

ORDERED: That the Settlement filed on August 17, 2004, by Blackstone Gas Company and the Attorney General, is hereby APPROVED; and it is

FURTHER ORDERED: That Blackstone Gas Company shall file rates and charges consistent with the terms of the Settlement, to become effective November 1, 2004.

By Order of the Department,

/s/ \_\_\_\_\_  
Paul G. Afonso, Chairman

/s/ \_\_\_\_\_  
James Connelly, Commissioner

/s/ \_\_\_\_\_  
W. Robert Keating, Commissioner

/s/ \_\_\_\_\_  
Eugene J. Sullivan, Jr., Commissioner

/s/ \_\_\_\_\_  
Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Act of 1971).